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C O N F I D E N T I A L SECTION 01 OF 02 BUCHAREST 000205

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TAGS: EFIN ECON IMF EUN PREL PGOV RO
SUBJECT: ROMANIA AND IMF REACH AGREEMENT ON 19.5 BILLION
EURO FINANCING PACKAGE

REF: BUCHAREST 180

Classified By: Charge d'Affaires Jeri Guthrie-Corn for reasons 1.4 (b) and (d).

¶1. (U) International Monetary Fund (IMF)-led negotiations with the Government of Romania (GOR) over a financial assistance package successfully concluded on March 25th. The IMF, European Commission (EC), World Bank (WB), and other international financial institutions (IFIs) (principally the European Bank for Reconstruction and Development (EBRD)) have agreed with the GOR to a two-year, 19.5 billion euro (26.29 billion USD) package. The centerpiece of the announced plan is a 12.5 billion euro equivalent standby agreement with the IMF. For its part, the EC has agreed to an additional five billion euro in support, while the WB and IFIs will each contribute approximately one billion euro. The GOR must now finalize the deal through a formal letter of intent to the IMF which must be approved by the IMF Board. Assuming that goes smoothly, the National Bank of Romania (BNR) should be able to draw the first five billion euro funding tranche in late April or early May.

¶2. (U) Although the full details of the various components of the program have yet to be released, the IMF characterized the overall program as one that will "cushion the effects of a sharp drop in private capital inflows while implementing policy measures to address the external and fiscal imbalances and to strengthen the financial sector." During a press conference announcing the package, the head of the IMF negotiating team, Jeffrey Franks, stated that the program will maintain the BNR's current inflation-targeting policy and not change the BNR's foreign exchange rate "managed free-float" policy. The IMF program will target a GOR budget deficit of 5.1 percent of GDP in 2009, allowing the GOR to maintain a certain level of social spending, while also working with the GOR to bring the fiscal deficit below three percent of GDP by 2011.

¶3. (U) To ensure the continued stability of the Romanian banking system and to increase liquidity in credit markets, the IMF program envisions having the BNR cut its minimum foreign currency reserve requirements for commercial banks. As most of the large domestic banks are foreign-owned, the IMF plans to meet with the CEOs of the ten largest foreign banks in Romania to ensure that they reaffirm the established credit lines with their subsidiaries and to extract a promise that any released reserves will be kept in Romania and not repatriated.

¶4. (U) The broader program will seek to improve GOR fiscal capacity through more effective and transparent budgeting. The public sector will be targeted for reform, with the goal of replacing the current employee pay system -- where generally low take-home pay is supplemented heavily with

bonuses -- with a common pay scale across the various ministries. The public pension system will be a focal point for reform, and state-owned companies will be more closely monitored to ensure they maintain reasonable spending plans.

¶5. (C) Comment. After taking very adamant public stances in late 2008 that Romania would not go to the IMF, the political leadership -- including President Basescu, Prime Minister Boc, and PSD leader Mircea Geoana -- have done a complete about-face in under three months. Romania should be commended for taking this more pro-active approach while there is still some economic breathing room, rather than waiting for a burgeoning crisis to force its hand. While the long-awaited announcement of an IMF program should provide a framework for greater financial sector stability and more predictable GOR budget execution through 2009, the devil will be in the details. An immediate issue with the announced program is the high budget deficit Romania will be allowed to run. Admittedly, this is based on very pessimistic IMF projections of minus 4 percent GDP growth with a resulting, very sharp decline in GOR revenues; a slightly better GDP performance could in theory keep the deficit lower. However, for a country that routinely overshoots deficit targets, an allowance for 5.1 percent of GDP may be treated, if history is any guide, as a license to spend 1-2 percent more than that. Romania has a very poor track record of seeing IMF agreements through to the bitter end -- not one, in fact, has been completed, with targets fully met, in the post-communist era. The jury is still out as to whether or not this agreement will stick for a full two years, or if it will be abandoned at the first glimmer of an economic recovery. The agreement also depends on the cooperation of commercial banks

not to repatriate capital in response to lower BNR reserve requirements; even gentlemen's agreements with the IMF may not be enough to keep the money in Romania if parent banks come under severe distress.

¶6. (C) Comment continued. The final outlines of the package also reveal the tough bargaining within the GOR ruling coalition over its terms, with the PSD appearing to have won important concessions from their PD-L partners and, in turn, from the IMF. The high fiscal deficit, focus on social spending, and promise of pension reform (which may be code for shoring up funding of traditional "pillar 1" state pensions at the possible expense of "pillar 2" private pension accounts) all appear to have PSD fingerprints on them. PD-L leaders, Basescu especially, aren't going to sit back and let Geoana take all the credit, but the terms certainly provide plenty of fodder for the fall presidential election campaign. Yet another wild card is the reaction of public sector workers, who have threatened crippling strikes if the IMF terms are too austere. At first glance the package could mollify some of their concerns and thus remove a potential major obstacle to implementation, but that is not a given even if the PSD publicly backs the agreement. Post will report more extensively on the terms of the agreement, and its impact in the political sphere, in the coming weeks. End Comment.
GUTHRIE-CORN